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SUBJECT: MARKET PLAYERS FACE THE NEW REALITIES

REF: ANKARA 1153

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[1](#)1. (SBU) Summary: Istanbul market analysts are grappling with the new political landscape following Saturday's parliamentary vote against permitting U.S. troops. The development was a shock: despite difficulties in negotiations, the market had long assumed (and priced in) a positive outcome. While some observers still hold out hope a second vote will be held after AK deputies take in the market consequences of their action, others are less sanguine. All agree that what is required now is renewed commitment to the IMF program. Prime Minister Gul's pre-market opening announcement of agreement on the 2003 budget with the IMF is being taken as a sign that he understands this reality. Some doubt whether such a policy is sustainable in the medium term, however, as a war's contractionary impact hits home. End Summary.

[1](#)2. (SBU) A Jaw-dropping Surprise: Saturday's decision was a shock to the market, which despite tough rhetoric had never really doubted that at the end of the day Turkey would hew to its strategic partnership with the U.S. and recognize the important role a U.S. package could play in counterbalancing an Iraq operation's economic impact. As J.P. Morgan's Koray Arikan commented Saturday night after the vote, "the markets had priced in the deal, and viewed the parliamentary process as cosmetics." Indeed, at the range of brokerages we canvassed last week there was little doubt that approval would come, and more interest in the mechanics of how the U.S. assistance (which all saw as critical to the sustainability of Turkey's debt) would function.

[1](#)3. (SBU) A Silver Lining: Coupled with concern about how Turkey will cover its financing gap without assistance, however, some analysts see a hint of a silver lining. If previously there was a perception that the government was stalling in its negotiations with the IMF in anticipation of completion of the U.S. assistance package, there is now belief that the government has put itself at the mercy of the IMF, and has no choice but to accept its conditions without exception. ATA Invest Board Member Mehmet Sami and Chief Economist Altug Karamenderes told us on March 3 that continuance of the IMF program, not "temporary" U.S. assistance, remains the most important issue for investors. The two saw in Prime Minister Gul's morning press conference an indication that he understood this reality, and believe that indications of progress on the IMF agreement will help blunt the vote's negative impact on Turkish markets.

[1](#)4. (SBU) Sustainability: Both Sami and Karamenderes questioned, however, whether the government will be able to sustain this policy in the medium term, pointing out that the figures Gul announced in meeting Turkey's 6.5 percent primary surplus target, while IMF blessed, are very ambitious. They also noted that they represent a shift from AK's earlier populist stance to agreement to squeeze savings out of the public sector, and will be politically difficult. Most critically, a variety of looming factors, including weak demand, increasing oil prices, tourism declines, and increased military spending, may "strangle growth" and leave the government far short of its revenue targets. The cascading challenges, in Sami's and Karamenderes' view, may lead the government to "give up" and abandon the program at some point this summer or fall. Alternatively, they suggested, the government might at that point move to restructure its domestic and foreign debt, or, in a worst case scenario, default, a possibility they regarded phlegmatically. "Opportunistic investors are out there waiting," they said, arguing that default has lost some of its past stigma.

15. (SBU) Comment: The vote came as a shock to Istanbul markets and observers, and has shaken market confidence. The government's quick moves on the IMF front have dampened some of that impact, however. Sami and Karamanderes did note that ironically if a second vote were successful the end result would be the best of all possible worlds: unblocking of large American assistance, but only after the government had pushed the IMF program further than it was previously willing to go.
End Comment.
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